No. 14735

United States
Court of Appeals
for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ROBERT H. MILLER and DORIS K. MILLER,

Respondents.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—7-8-55

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF COUNSEL

MAX B. LEWIS,
Continental Bank Bldg.,
Salt Lake City, Utah;

FLOYD K. HASKELL,
Denver Club Building,
Denver, Colorado;

HARLEY W. GUSTIN,
Walker Bank Bldg.,
Salt Lake City, Utah,

For Respondents.

H. BRIAN HOLLAND,
Assistant United States Attorney General, Tax Division, Department of Justice;

ELLIS N. SLACK,
Special Assistant United States Attorney General,
Washington, D. C.,

For Petitioner.

The Tax Court of the United States

Docket No. 45894

ROBERT H. MILLER and DORIS K. MILLER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1952

Dec. 12—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 22—Copy of petition served on General Counsel.

1953

Feb. 17—Answer filed by General Counsel.

Feb. 17—Request for hearing in Los Angeles filed by General Counsel.

Feb. 25—Notice issued placing proceeding on Los Angeles, California, calendar, Service of answer and request made.

Aug. 28—Hearing set December 7, 1953, Los Angeles, California.

Nov. 12—Entry of appearance of Erwin Lampe as counsel filed.

Dec. 14—Hearing had before Judge Withey, on merits. Stipulation of facts and appearance of Max B. Lewis, Esq., filed. Briefs due 2/15/54. Replies due 3/17/54.

1954

Jan. 26—Brief filed by taxpayer.

Feb. 5—Motion for extension to March 15, 1954, to file brief filed by General Counsel. 2/8/54 Granted.

Mar. 15—Brief filed by General Counsel.

Mar. 16—Copy of taxpayer's brief served on General Counsel.

Mar. 18—Transcript of hearing, 12/14/53, filed.

Apr. 13—Motion for extension to April 30, 1954, to file reply brief filed by taxpayer. 4/13/54 Granted.

Aug. 17—Memorandum findings of fact and opinion filed, Withey, Judge. Decision will be entered under rule 50. Copy served.

Nov. 2—Agreed computation filed.

Nov. 8—Decision entered, Judge, Withey, Div. 4.

1955

Jan. 28—Petition for review by U. S. Court of Appeals, Ninth Circuit, with statement of points, filed by General Counsel.

Feb. 7—Proof of service filed. (Counsel.)

Feb. 15—Proof of service of petition for review filed. (Counsel.)

Feb. 15—Proof of service of petition for review filed. (Taxpayer.)

Feb. 28—Motion for extension to April 28, 1955, for filing the record and docketing the appeal filed by General Counsel.

Mar. 1—Order extending time to April 28, 1955, for filing the record and docketing the appeal, entered.

1955

Apr. 12—Proposed statement of points with notice of service by mail thereon filed by General Counsel.

Apr. 12—Designation of contents of record with notice of service by mail thereon filed by General Counsel.

The Tax Court of the United States

Docket No. 45894

ROBERT H. MILLER and DORIS K. MILLER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies set forth by the said Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols LA:IT:90D:-CTF), dated October 31, 1952, and as a basis for their proceeding, allege as follows.

1. Petitioners are, and at all times mentioned herein were, husband and wife, with residence at 11459 Bellagio Road, Los Angeles, California. The return for the period the year 1948 and for the

period the year 1949 herein involved were filed with the Collector for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to the petitioners on October 31, 1952.

3. The deficiency, as determined by the Commissioner, is in income taxes for the calendar year 1948, in the amount of $983.72, and in income taxes for the calendar year 1949, in the amount of $9,454.06. The entire amount of the deficiency is in dispute.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erroneously increased petitioners' income for the year 1948 in the amount of $2,941.74 by decreasing petitioner's distributive share of loss from the partnership I. W. Bosworth and Associates for its taxable year July 1, 1947, to January 31, 1948, by eliminating from allowable deductions rentals paid to the Treasurer of the United States under Section 17 of the Act of February 25, 1920 (41 Stat. 437), as amended by the Act of August 8, 1946 (60 Stat. 950), and filing fees paid under CFR Title 43, Chapter 1, Part 191.11, and recording fees.

(b) The Commissioner erroneously increased petitioners' income for the year 1949 in the amount of $20,720.16 by decreasing petitioners' distributive share of loss from partnerships as follows:

I. Loss from I. W. Bosworth and Associates for the year ended January 31, 1949, reduced $10,435.03 by eliminating from allowable deductions rentals paid to the Treasurer of the United States under Section 17 of the Act of February 25, 1920 (41 Stat. 437), as amended by the act of August 8, 1946 (60 Stat. 950), and filing fees paid under CFR Title 43, Chapter 1, Part 191.11, and recording fees.

II. Loss from Robert H. Miller and Associates for the period ended January 31, 1949, reduced $1,898.83 by elimination of such rentals and fees.

III. Loss from Equity Oil Company for the period May 1, 1949, to December 31, 1949, reduced $5,986.30 by the elimination of such rentals and fees.

IV. Loss from Robert H. Miller and Associates for the period February 1, 1949, to April 30, 1949, reduced $2,400.00 by eliminating from allowable deductions delay lease rentals paid to hold fee land leasehold later abandoned, and by eliminating from allowable deductions filing and recording fees in connection with other properties to which title was never obtained.

(c) The Commissioner erroneously computed the amount of deficiency assessed by him, particularly in reference to the Equity Oil Company partnership in connection with which he has proposed disallowance of $3,511.75 in excess of net lease rentals claimed, of which petitioners' share would be $877.94

5. The facts upon which petitioners rely as the basis for their proceeding are as follows:

(a) The right to prospect and produce oil and gas on the public domain is granted by the Act of February 25, 1920 (41 Stat. 437), as amended. The Act of August 21, 1935 (49 Stat. 674), materially changed the original leasing act by granting the right to prospect for oil and gas under a lease, rather than under a prospecting permit. The Act of August 8, 1946 (60 Stat. 950), liberalized the provisions of the Act of August 21, 1935, supra, in order to encourage prospecting on the public domain and the discovery of new sources of supply of oil and gas.

(b) So far as oil and gas are concerned, the public domain is directly and completely divided into two general classifications: (1) Lands known to contain oil or gas in paying quantities, which are described as lands within any known geological structure of a producing oil or gas field, and (2) lands not known to contain oil or gas in paying quantities, commonly referred to as wildcat lands. In the latter classification, prospecting is necessary to determine whether the lands contain oil or gas in paying quantities, and to determine whether the lands have any value whatsoever, and the right to do such prospecting may be secured by obtaining a "non-competitive" lease from the Government. It is these prospecting rights or "non-competitive" leases which are herein involved.

(c) Section 17 of the Act of February 25, 1920, supra, as amended by Section 3 of the Act of August 8, 1946, sets forth the procedures to be followed by the Secretary of the Interior in leasing all lands subject to disposition under the Act. This Section of the Act reads: "* * * When the lands to be leased are within any known geologic structure of a producing oil or gas field, they shall be leased to the highest responsible qualified bidder * * * upon the payment of such bonus as may be accepted by the Secretary * * * When the lands are not within any known geological structure of a producing oil or gas field, the first person making application for the lease who is qualified to hold a lease under this Act shall be entitled to a lease of such lands without competitive bidding * * * All leases issued under this Section shall be conditioned upon the payment by lessee in advance of a rental of not less than 25 cents per acre per annum * * *"

(d) The Act requires the Secretary to collect a rental from all leases issued under the Act. In addition the Act empowers the Secretary to sell a lease on proven ground to the highest qualified bidder. The Act does not empower the Secretary to sell prospecting rights or "non-competitive" leases.

(e) Since these "non-competitive" leases cannot legally be sold by the Government, any taxing theory under which lessees' rentals are to be capitalized as acquisition cost must start with the premise of placing lessee in a theoretical illegal position.

(f) That the usage by the Congress of the word "rentals" in the Land Act, and the usage by Congress of the word "rentals" in listing allowable deductions under the Internal Revenue Code was with the intent and understanding that the same meaning was intended in both instances and that these rentals paid to the Treasurer of the United States are deductible rentals under the Internal Revenue Code.

(g) The lease rentals on the Mott lease were rentals on a speculative fee lease which petitioners and associates did not drill and which lease was formally abandoned by permitting same to lapse at the end of its one-year life on March 12, 1950, and that from a business and economic standpoint the loss belongs in 1949 when rental was paid and when the decision not to drill was made by the partners in Robert H. Miller and Associates.

Wherefore, petitioners pray that this Court may hear the proceeding and determine that there is no deficiency in income tax against the petitioners for the calendar years 1948 and 1949.

/s/ ROBERT H. MILLER,
Petitioner.

/s/ DORIS K. MILLER,
Petitioner.

Duly verified.

EXHIBIT A

U. S. Treasury Department
Office of Internal Revenue Agent in Charge
417 South Hill Street
Los Angeles 13, California

Form 1230-A (1951)

Seal

October 31, 1952.

Internal Revenue Service,
Los Angeles District,
LA:IT:90D:CTF,

Mr. Robert H. Miller and
Mrs. Doris K. Miller,
Husband and wife,
1385 Westwood Boulevard,
Los Angeles 24, California.

Dear Mr. and Mrs. Miller:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1948, and 1949, discloses a deficiency of $10,437.78 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with the Tax Court of the United States, at its principal address,

Exhibit A—(Continued)

Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia, in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

JOHN B. DUNLAP,
Commissioner;

By GEORGE D. MARTIN,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form 1276.
Agreement Form.

Exhibit A—(Continued)

Statement

LA:IT:90D:CTF

Mr. Robert H. Miller and
Mrs. Doris K. Miller
Husband and Wife
1385 Westwood Boulevard
Los Angeles 24, California

Tax Liability for the Taxable Years
Ended December 31, 1948 and 1949

Year		Deficiency
1948	Income tax	$ 983.72
1949	Income tax	9,454.06
	Total	$10,437.78

In making this determination of your income tax liability careful consideration has been given to the report of examination dated October 15, 1951, to your protest dated December 3, 1951, and to the statements made at the conferences held.

Adjustment to Net Income
Taxable year ended December 31, 1948

Net income as disclosed by return	$22,569.36
Unallowable deduction:	
(a) Partnership loss decreased	2,941.74
Net income adjusted	$25,511.10

Explanation of Adjustment

(a) The loss from partnership claimed in your return is decreased in the amount of $2,941.74, computed as shown below.

Your correct distributive share of loss from the partnership I. W. Bosworth and Associates for its taxable year July 1, 1947, to January 31, 1948

	($65.34)
Amount claimed	(3,007.08)
Decrease	$2,941.74

It is held that amounts, included in the decrease of loss stated above, deducted as "rental expense," representing payments made under United States Government oil and gas leases do not constitute proper deductions under the provisions of Section 23(a) of the Internal Revenue Code.

Exhibit A—(Continued)

Computation of Tax
Taxable Year Ended December 31, 1948

Net income adjusted		$25,511.10
Less Exemptions		2,400.00
Balance, subject to surtax and normal tax		$23,111.10
One-half of $23,111.10		$11,555.55
Tentative tax	$3,231.11	
Less reduction under Sec. 12 (c), I. R. C.	407.73	
Total tax on one-half of net income		$ 2,823.38
Combined tax ($2,823.38 x 2)		$ 5,646.76
Correct income tax liability		$ 5,646.76
Income tax liability shown on return, account No. 9110733		$ 4,663.04
Deficiency in income tax		$ 983.72

Adjustment to Net Income
Taxable Year Ended December 31, 1949

Net income as disclosed by return	$28,039.72
Unallowable deduction:	
(a) Partnership loss decreased	20,720.16
Net income adjusted	$48,759.88

Explanation of Adjustment

(a) The loss claimed in your return from the following partnerships is decreased in the amount of $20,720.16, computed as shown below:

Partnership	Taxable Year	Your Distributive Share As Determined	Your Distributive Share Claimed
Equity Oil Company	May 1, 1949 to Dec. 31, 1949	$(226.80)	$(6,213.10)
I. W. Bosworth & Associates	Ended Jan. 31, 1949	(1,702.97)	(12,138.00)
Robert H. Miller & Associates	Aug. 1, 1948 to Jan. 31, 1949	(165.46)	(2,064.29)
Robert H. Miller & Associates	Feb. 1, 1949 to Apr. 30, 1949	(12.50)	(2,412.50)
Total		$(2,107.73)	$(22,827.89)
Decrease		$(20,720.16)	

Exhibit A—(Continued)

It is held that amounts, included in the decrease of loss stated above, deducted as "rental expense," representing payments made under United States Government oil and gas leases do not constitute proper deductions under the provisions of Section 23(a) of the Internal Revenue Code.

Computation of Tax
Taxable Year Ended December 31, 1949

Net income adjusted		$48,759.88
Less: Exemptions		1,800.00
Balance, subject to surtax and normal tax		$46,959.88
One-half of $46,959.88		$23,479.94
Tentative tax	$9,253.17	
Less reduction under Sec. 12(c) I. R. C.	1,130.38	
Total tax on one-half of net income		$ 8,122.79
Combined tax ($8,122.79 x 2)		$16,245.58
Correct income tax liability		$16,245.58
Income tax liability shown on return, account No. 3208623		6,791.52
Deficiency of income tax		$ 9,454.06

Received and filed December 12, 1952, T.C.U.S.

Served December 22, 1952.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayers, admits and denies as follows:

1. Admits that the petitioners are husband and wife, and that the returns for the years 1948 and 1949 herein involved were filed with the Collector for the Sixth District of California; denies the remaining allegations contained in paragraph 1 of the petition.

2 and 3. Admits the allegations contained in paragraphs 2 and 3 of the petition.

4. Denies the allegations of error contained in paragraph 4 of the petition and all subparagraphs and subdivisions thereof.

5. Denies the allegations contained in paragraph 5 of the petition and all subparagraphs thereof.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES W. DAVIS, E.C.C.,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
District Counsel.

E. C. CROUTER,
Appellate Counsel.

FRANCIS B. CAMPBELL, JR.,
Special Attorney, Bureau of Internal Revenue.

Received and filed February 17, 1953. T.C.U.S.

[Title of Tax Court and Cause.]

MEMORANDUM FINDINGS OF FACT AND OPINION

Withey, Judge:

The respondent determined deficiencies of $983.72 and $9,454.06 in the income tax of the petitioners for 1948 and 1949, respectively. The only issues for determination are (1) whether first year payments made on non-competitive oil and gas leases issued by the United States were deductible as rentals, and (2) whether filing fees paid in connection with applications made for non-competitive oil and gas leases were deductible as business expenses in the years of payment. All other issues have been disposed of by stipulation of the parties.

Findings of Fact

The facts have been stipulated and are found accordingly.

The petitioners are, and were during 1948 and 1949, husband and wife and residents of Los Angeles, California. The petitioners filed joint income tax returns, prepared on the cash recipts and disbursements basis, for 1948 and 1949 with the collector for the sixth district of California.

Robert H. Miller, sometimes hereinafter referred to as the petitioner, is a geologist and is, and has been, engaged in various enterprises in the oil and gas field.

Under date of July 1, 1947, the petitioner, I. W. Bosworth and Glenn C. Ferguson formed a partnership, with each having a one-third interest, known as I. W. Bosworth and Associates, and sometimes hereinafter referred to as the Bosworth partnership. Under date of August 1, 1948, petitioner, I. W. Bosworth and Glenn C. Ferguson formed a partnership, with each having a one-third interest, known as Robert H. Miller and Associates, and sometimes hereinafter referred to as the Miller partnership. Under date of May 1, 1949, petitioner, I. W. Bosworth, Glenn C. Ferguson and J. N. Huber formed a partnership, with each having a one-fourth interest, known as Equity Oil Company, and sometimes hereinafter referred to as the Equity partnership. All the foregoing partnerships were formed for the purpose of acquiring oil and gas leases for investment and development. Each of the partnerships reported its income on the cash receipts and disbursements basis.

During the years involved herein the above-mentioned partnerships acquired non-competitive oil and gas leases on United States Government lands. All of the leases were issued pursuant to the authority of the Leasing Act of 1920 (41 Stat. 437), as amended. Applications for such leases, accompanied by a filing fee of $10, were made by the respective partnerships through their individual members, and the leases when issued were executed by the partnerships, through their individual members, and

on behalf of the United States Government by a properly authorized official.

During its fiscal year ended January 31, 1948, the Bosworth partnership paid filing fees of $173 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling $8,652.22. In determining the amount of the petitioner's distributive share of the partnership's loss for the partnership's fiscal year ended January 31, 1948, to be allowed as a deduction in the petitioners' income tax return for 1948, the respondent determined that said fees and first year payments totaling $8,825.22 were not allowable deductions.

During its fiscal year ended January 31, 1949, the Bosworth partnership paid filing fees of $333 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling $30,972.08, or a total of $31,305.38. During its fiscal period ended January 31, 1949, the Miller partnership paid filing fees of $312 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling $5,384.50, or a total of $5,696.50. During the period beginning May 1, 1949, and ended December 31, 1949, the Equity partnership paid filing fees of $330 in connection with applications made for non-competitive oil and gas leases, and on non-competitive oil and gas leases made first year payments totaling $20,103.44, or a

total of $20,433.44. In determining the amount of the petitioner's distributive share of the partnership loss from the foregoing partnerships to be allowed as deductions in the petitioners' income tax return for 1949, the respondent determined that said filing fees and first year payments were not allowable deductions.

The non-competitive oil and gas leases obtained by the various partnerships and involved herein contained the following:

> Section 1. Rights of Lessee—That the lessor, in consideration of rents and royalties to be paid, and the conditions and covenants to be observed as herein set forth, does hereby grant and lease to the lessee the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and gas deposits except helium gas in or under the following-described tracts of land * * * together with the right to construct and maintain thereupon all works, buildings, plants, waterways, roads, telegraph or telephone lines, pipe lines, reservoirs, tanks, pumping stations, or other structures necessary to the full enjoyment thereof, for a period of 5 years, and so long thereafter as oil or gas is produced in paying quantities * * *.

Opinion

The first issue for determination is whether the first year payments made by the various partnerships on the non-competitive oil and gas leases ob-

tained by them from the United States were deductible by them as rentals. The petitioners contend that the payments were so deductible while the respondent contends that the payments constituted capital expenditures and were not deductible as rentals. On brief, filed prior to our decision in Olen F. Featherstone, 22 T.C. .... No. 96 (filed June 30, 1954), the respondent directs our attention to that proceeding and states that the payments here involved were made under the same type of United States Government leases as were in issue there. From an examination of the leases in evidence in the instant proceeding, the foregoing statement of the respondent appears to be correct. In the Featherstone case, we held that the first year payments made on the non-competitive oil and gas leases issued by the United States and there involved were true rentals and were deductible as such by the payors. However, we pointed out that our holding was not necessarily dispositive of a case in which the payment claimed by the taxpayer as a deductible expense (or determined by the Commissioner as non-depletable income) is made in respect of a year in which mineral is produced in paying quantities. The instant proceeding was submitted on a stipulation of facts which makes no mention of any production at any time from any of the leases here involved. Consequently, for present purposes we conclude that none of the payments here in question were in respect of a year in which mineral was produced in paying quantities. In view of what has been said above, we think our holding in the Featherstone case is ap-

plicable and controlling here. Accordingly, we hold for the petitioners on this issue. See United States v. Dougan (C.A. 10) .... F. 2d ...., decided July 8, 1954.

The remaining issue is whether filing fees paid by the various partnerships in connection with applications made for non-competitive oil and gas leases constituted deductible business expenses for the years in which paid. The respondent contends that since the filing fees were paid upon application for leases with a primary term of five years with a possible term beyond that period, the fees were capital expenditures and as such were not deductible as business expenses. Aside from merely stating that the question of the deductibility of the fees was in issue in the proceeding, the petitioners make no further mention of the matter on brief. Other than showing that the fees accompanied applications made for non-competitive oil and gas leases, the record is silent as to the fees, the circumstances under which they were paid, whether leases were issued pursuant to such application, and, if so, what the term or terms of such leases were. In the state of the record, the respondent's action in determining that the fees were not deductible expenses is sustained for lack of proof to show error.

Decision will be entered under Rule 50.

Received August 9, 1954.

Served August 17, 1954.

Filed August 17, 1954.

The Tax Court of the United States, Washington

Docket No. 45894

ROBERT H. MILLER and DORIS K. MILLER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent.

DECISION

Pursuant to the determination of this Court, as set forth in its Memorandum Findings of Fact and Opinion, filed August 17, 1954, the parties filed an agreed computation for entry of decision. In accordance with said computation, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $19.26 and $122.64.

[Seal] /s/ G. G. WITHEY,
Judge.

Entered November 8, 1954.

Served November 9, 1954.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed, by and between the parties hereto through their respective counsel, that the following facts are true and may be found as facts by The Tax Court of the United States:

1. Petitioners are and were, during the years hereto involved, husband and wife, and residents of Los Angeles, California. Petitioner, Robert H. Miller, is a geologist and is and has been engaged in various enterprises in the oil and gas field.

2. Petitioners filed joint Federal income tax returns, Form 1040, for the calendar years 1948 and 1949, with the Collector of Internal Revenue for the Sixth District of California. Copies of said returns are attached hereto and marked Exhibits 1-A and 2-B, respectively.

3. Under date of July 1, 1947, petitioner, Robert H. Miller, together with I. W. Bosworth and Glenn C. Ferguson, entered into a partnership known as I. W. Bosworth and Associates for the purpose of acquiring oil and gas leases for investment and development, each of the partners having an equal share in the business. A partnership return, Form 1065, covering the period from July 1, 1947, to January 31, 1948, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is at-

tached hereto and marked Exhibit 3-C. A partnership return, Form 1065, covering the period from February 1, 1948, to January 31, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 4-D.

4. Under date of August 1, 1948, petitioner, Robert H. Miller, together with I. W. Bosworth and Glenn C. Ferguson, entered into a partnership known as Robert H. Miller and Associates, for the purpose of acquiring oil and gas leases for investment and development, each partner having an equal share in said business. A partnership return, Form 1065, covering the period from August 1, 1948, to January 31, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 5-E. A partnership return, Form 1065, covering the period from February 1, 1949, to April 30, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 6-F. Said partnership was terminated on April 30, 1949.

5. Under date of May 1, 1949, petitioner, Robert H. Miller, together with I. W. Bosworth, Glenn C. Ferguson and J. N. Huber entered into a partnership known as Equity Oil Company for the purpose of acquiring oil and gas leases for investment and development, each partner having an equal share

in said business. A partnership return, Form 1065, covering the period May 1, 1949, to December 31, 1949, was filed by the partnership with the Collector of Internal Revenue for the Sixth District of California. A copy of said return is attached hereto and marked Exhibit 7-G.

6. The petitioners herein, and the partnerships heretofore mentioned, all reported their income on the cash receipts and disbursements basis.

7. All of the partnerships hereinabove referred to acquired so-called "non-competitive" oil and gas leases on United States Government lands during the taxable periods herein involved. The Administration of such Government lands is governed by the Act of February 24, 1920, entitled "An Act to promote the mining of coal, phosphate, oil, oil shale, gas and sodium on the public domain," as amended (41 Stat. 437) and the regulations promulgated thereunder, specifically Title 43, Chapter 1, Part 192, Code of Federal Regulations.

8. In connection with the acquisition of the oil and gas leases above referred to, the partnerships, through their individual partners, filed "Applications for Oil and Gas Leases," pursuant to the procedure prescribed in the above-mentioned Statute and regulation. Illustrative copies of said "Application" forms are attached hereto and marked Exhibits 8-H and 9-I.

9. In connection with the oil and gas leases acquired by said partnerships during said taxable

periods, Form 4-213, "Lease of Oil and Gas Lands Under the Act of February 25, 1920, as Amended," were executed by the partnerships, through their partners, and on behalf of the United States Government by a properly authorized official. Copies of said forms are attached hereto and marked Exhibits 10-J and 11-K.

10. During the fiscal year ended January 31, 1949, the partnership, I. W. Bosworth and Associates, in entering into such "non-competitive" oil and gas leases with the United States Government presented "Applications for Oil and Gas Leases" and paid filing fees therewith in the amount of $173.00. The partners subsequently entered into "non-competitive" leases of oil and gas lands with the United States Government, which leases provided for the payments of "rentals" in advance "for the first lease year, a rental of 50 cents per acre." During the partnership year ended January 31, 1948, said partnership paid such lease "rentals" in the amount of $8,652.22. The partnership deducted such filing fees in the amount of $173.00, and such "rental" payments in the amount of $8,652.22 on its income tax return filed for the taxable period ending January 31, 1948. Respondent has held that such filing fees are a part of the cost of the lease and as such are a capital expenditure and that the "rental" payments for the first year constitute a lease bonus and as such constitute a capital charge. Respondent has held that the loss of I. W. Bosworth & Associates for this period ended January

31, 1948, should be reduced to $196.00, of which petitioners' share would be $65.34.

11. Respondent determined that petitioners' distributive share of losses from certain partnerships engaged in the business of acquiring oil and gas leases for investment and development should be reduced from $22,827.89 as claimed in petitioners' 1949 joint income tax return to $2,107.73 and that petitioners' taxable income should be increased by $20,720.16 with a resulting additional tax of $9,454.06. Such partnerships comprise the following:

Name	Period Ending	Loss Claimed by Petitioners	Loss Allowed by Respondent
Equity Oil Company	12-31-49	$ 6,213.10	$ 226.80
I. W. Bosworth & Associates	1-31-49	12,138.00	1,702.97
Robert H. Miller & Associates	1-31-49	2,064.29	165.46
Robert H. Miller & Associates	4-30-49	2,412.50	12.50
Total		$22,827.89	$2,107.73

Petitioners' distributive share of adjustments as determined by respondent, $20,720.16.

12. For the fiscal year ended January 31, 1949, the partnership, I. W. Bosworth and Associates, filed its return showing as ordinary net income a loss of $36,413.99, and $12,138.00 of such loss as petitioners' distributive share thereof. During said I. W. Bosworth and Associates fiscal year ended January 31, 1949, said partnership paid fees in the amount of $333.00 in connection with the filing of "Applications for Oil and Gas Leases" and paid First lease year "Rentals" on "non-competitive"

United States Government Leases of Oil and Gas Lands in the amount of $30,972.08. Such filing fees and "rental" payments were taken as deductions in said partnership return and respondent has determined that these items should be capitalized and that this partnership's ordinary loss should be reduced to $5,108.91 and that petitioners' distributive share of such loss should be $1.702.97.

13. For the period ending January 31, 1949, the partnership, Robert H. Miller and Associates, reported a loss of $6,192.87 and respondent has determined that deductions included in such loss should be reduced in the sum of $5,696.50 through capitalizing filing fees in the amount of $312.00 and first year "rentals" in the amount of $5,384.50 both of these items relating to "non-competitive" Government were as follows:

14. For the fiscal period February 1, 1949, through April 30, 1949, the partnership of Robert H. Miller and Associates reported a net loss of $7,237.50 with petitioners' share of such loss reported as $2,412.50. Respondent determined that such loss should be reduced by $7,200.00 and that petitioners' share of such loss should be reduced to $12.50. Items involved in this $7,200.00 adjustment oil and gas leases. Elimination of such deductions would result in reducing petitioners' share of loss from $2,064.29 as claimed by petitioners to a loss of $165.46 as determined by respondent for the partnership taxable year ended January 31, 1949.

Lease Rentals	$7,500.00
Filing Fees	80.00
Sub-total	$7,580.00
Less Lease Rentals Refunded Reported as Income by Petitioner and Eliminated Therefrom by Respondent	$ 380.00
Net Adjustment	$7,200.00

The $7,500.00 lease rentals item represents payment made in connection with the acquisition of a lease on a parcel of privately owned fee land identified as the Mott Lease. This transaction was not like the transactions relating to "non-competitive" Government oil and gas leases and it is agreed that such payment for the Mott Lease is to be capitalized for the year 1949 without prejudice to petitioners' right to recover such cost upon proof of abandonment of said lease in 1950. Filing fees deducted during the period ending April 30, 1949, relate to fee land lease proposals in connection with leases on fee lands, privately owned. No property acquisition followed and these are a proper deduction for this partnership in this period. This stipulation is without prejudice to the position of petitioners or respondent in reference to capitalization or expensing of filing fees on "non-competitive" Government leases.

15. During the period February 1, 1949, to April 30, 1949, the Robert H. Miller and Associates partnership received a refund of $380.00 in connection

with one of the Government "non-competitive" oil and gas leases due to a dispute as to title on one of its leases. Said partnership had reported the lease "rental" as a deduction during its year ended January 31, 1949, and showed the refund as income on its return for the period ending April 30, 1949. Respondent has determined that the deduction claimed should be capitalized for the period ended January 31, 1949, and consistently that this refund is a refund of capital and not income. If petitioners prevail and "rentals" of "non-competitive" United States Government oil and gas leases are not to be capitalized, then these refunds are income.

16. The partnership, Equity Oil Company, filed its first return for the period ending December 31, 1949, and showed a loss of $24,852.38 with petitioners' distributive share reported as $6,213.10. Respondent determined that filing fees of $330.00 and first year "rentals" of $23,615.19 relating to United States Government "non-competitive" oil and gas leases should be capitalized and reduced the loss to $907.19, of which petitioners' distributive share of loss would be $226.80. This partnership devoted part of its activities to securing a complete block of leases in one area for a compact drilling unit of land. This included certain lands where titles were uncertain and involved. This partnership did pay out lease "rentals" in the amount of $23,615.19 as set out above, but of this amount $3,511.75 was refunded during the period by the Bureau of Land Management which held that it could not properly

issue leases on lands involving this amount of "rentals" because of disputes over priority, survey lines, miners' rights and other complications. For bookkeeping purposes, this partnership kept such refunds in a separate account instead of showing same as an offset to "rentals" expense. The partnership return was filed showing income from return "rentals" as $3,511.75 and "rental" expense as $23,615.19. The amount at issue is $20,103.44, although respondent used $23,615.19 in the determination of the adjustment of this partnership's loss. If respondent prevails, proper adjustment shall be made in determining deficiency under Rule 50.

17. The issues involved are whether payments made for "first year lease rentals" on United States Government "non-competitive" leases are deductible "rentals" or whether such payments constitute a lease bonus and, as such represent capital expenditures, and the incidental issue as to whether or not filing fees paid in connection with the filing of "Applications for Oil and Gas Leases" are deductible expenses or a capital expenditure.

/s/ ERWIN LAMPE,
Counsel for Petitioners.

/s/ DANIEL A. TAYLOR, E.C.C.,
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

EXHIBIT 11-K

Form 4-213
(August, 1948)

United States
Department of the Interior
Bureau of Land Management

Office: Carson City.

Serial: 023897.

Abstracted & Audited.

Non-competitive

Lease of Oil and Gas Lands Under the Act of February 25, 1920, as Amended

This Indenture of Lease, entered into, in triplicate, as of the 1st day of Nov., 1949, by and between the United States of America, through the Bureau of Land Management, party of the first part, and Robert H. Miller, 1385 Westwood Blvd., Los Angeles 24, California, party of the second part, hereinafter called the lessee, under, pursuant, and subject to the terms and provisions of the act of February 25, 1920 (41 Stat. 437), as amended, hereinafter referred to as the act, and to all reasonable regulations of the Secretary of the Interior now or hereafter in force when not inconsistent with any express and specific provisions herein, which are made a part hereof.

Witnesseth:

Section 1. Rights of Lessee—That the lessor, in consideration of rents and royalties to be paid, and

(Exhibit 11-K—Continued)

the conditions and covenants to be observed as herein set forth, does hereby grant and lease to the lessee the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and gas deposits except helium gas in or under the following-described tracts of land:

T. 17 N., R. 58 E., M.D.M., Nevada,
Sec. 10, S½.
Section 31, All.

containing 962.60 acres, more or less, together with the right to construct and maintain thereupon all works, buildings, plants, waterways, roads, telegraph or telephone lines, pipe lines, reservoirs, tanks, pumping stations, or other structures necessary to the full enjoyment thereof, for a period of 5 years, and so long thereafter as oil or gas is produced in paying quantities; subject to any unit agreement heretofore or hereafter approved by the Secretary of the Interior, the provisions of said agreement to govern the lands subject thereto where inconsistencies with the terms of this lease occur.

Sec. 2. In consideration of the foregoing, the lessee hereby agrees:

(a) Bonds—(1) To maintain any bond furnished by the lessee as a condition for the issuance of this lease. (2) If the lease is issued non-competitively, to furnish a bond in a sum double the amount of the $1 per acre annual rental, but not less than $1,000 nor more than $5,000, upon the inclusion of

(Exhibit 11-K—Continued)

any part of the leased land within the geologic structure of a producing oil or gas field. (3) To furnish prior to beginning of drilling operations and maintain at all times thereafter as required by the lessor a bond in the penal sum of $5,000 with approved corporate surety, or with deposit of United States bonds as surety therefor, conditioned upon compliance with the terms of this lease, unless a bond in that amount is already being maintained or unless such a bond furnished by an approved operator of the lease is accepted.

Until a general lease bond is filed a non-competitive lessee will be required to furnish and maintain a bond in the penal sum of not less than $1,000 in those cases in which a bond is required by law for the protection of the owners of surface rights. In all other cases where a bond is not otherwise required, a $1,000 bond must be filed for compliance with the lease obligations not less than 90 days before the due date of the next unpaid annual rental, but this requirement may be successively dispensed with by payment of each successive annual rental not less than 90 days prior to its due date.

(b) Co-operative or unit plan—Within 30 days of demand, or if the land is within an approved unit plan, in the event such a plan is terminated prior to the expiration of this lease, within 30 days of demand made thereafter, to subscribe to and to operate under such reasonable co-operative or unit plan for the development and operation of the area, field,

(Exhibit 11-K—Continued)

or pool, or part thereof, embracing the lands included herein as the Secretary of the Interior may determine to be practicable and necessary or advisable, which plan shall adequately protect the rights of all parties in interest, including the United States.

(c) Wells—(1) To drill and produce all wells necessary to protect the leased land from drainage by wells on lands not the property of the lessor or lands of the United States leased at a lower royalty rate, or in lieu of any part of such drilling and production, with the consent of the Director of the Geological Survey, to compensate the lessor in full each month for the estimated loss of royalty through drainage in the amount determined under instructions of said Secretary; (2) at the election of the lessee, to drill and produce other wells in conformity with any system of well spacing or production allotments affecting the field or area in which the leased lands are situated, which is authorized and sanctioned by applicable law or by the Secretary of the Interior; and (3) promptly after due notice in writing to drill and produce such other wells as the Secretary of the Interior may require to insure diligence in the development and operation of the property.

(d) Rentals and royalties—(1) To pay the rentals and royalties set out in the rental and royalty schedule attached hereto and made a part hereof.

(Exhibit 11-K—Continued)

(2) It is expressly agreed that the Secretary of the Interior may establish reasonable minimum values for purposes of computing royalty on any or all oil, gas, natural gasoline, and other products obtained from gas; due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters and whenever appropriate, after notice and opportunity to be heard.

(3) When paid in value, such royalties on production shall be due and payable monthly on the last day of the calendar month next following the calendar month in which produced. When paid in amount of production, such royalty products shall be delivered in merchantable condition on the premises where produced without cost to lessor, unless otherwise agreed to by the parties hereto, at such times and in such tanks provided by the lessee as reasonably may be required by the lessor, but in no case shall the lessee be required to hold such royalty oil or other products in storage beyond the last day of the calendar month next following the calendar month in which produced. The lessee shall not be responsible or held liable for the loss or destruction of royalty oil or other products in storage from causes over which he has no control.

(4) Royalties shall be subject to reduction on the entire leasehold or on any portion thereof segre-

(Exhibit 11-K—Continued)

gated for royalty purposes if the Secretary of the Interior finds that the lease cannot be successfully operated upon the royalties fixed herein, or that such action will encourage the greatest ultimate recovery of oil or gas or promote conservation.

(e) Contracts for disposal of products—Not to sell or otherwise dispose of oil, gas, natural gasoline, and other products of the lease except in accordance with a contract or other arrangement first approved by the Director of the Geological Survey or his representative, such approval to be subject to review by the Secretary of the Interior but to be effective unless and until revoked by the Secretary or the approving officer, and to file with such officer all contracts or full information as to other arrangements for such sales.

(f) Statements, plats, and reports—At such times and in such form as the lessor may prescribe, to furnish detailed statements showing the amounts and quality of all products removed and sold from the lease, the proceeds therefrom, and the amounts used for production purposes or unavoidably lost; a plat showing development work and improvements on the leased lands and a report with respect to stockholders, investment, depreciation, and costs.

(g) Well records—To keep a daily drilling record, a log, and complete information on all well surveys and tests in form acceptable to or prescribed by the lessor of all wells drilled on the leased lands,

(Exhibit 11-K—Continued)

and an acceptable record of all subsurface investigations affecting said lands, and to furnish them, or copies thereof to the lessor when required.

(h) Inspection—To keep open at all reasonable times for the inspection of any duly authorized officer of the Department, the leased premises and all wells, improvements, machinery, and fixtures thereon and all books, accounts, maps, and records relative to operations and surveys or investigations on the leased lands or under the lease.

(i) Payments—Unless otherwise directed by the Secretary of the Interior, to make rental, royalty, or other payments to the lessor, to the order of the Treasurer of the United States, such payments to be tendered to the manager of the district land office in the district in which the lands are located or to the Director of the Bureau of Land Management if there is no district land office in the State in which the lands are located.

(j) Diligence—Prevention of waste—Health and safety of workmen—To exercise reasonable diligence in drilling and producing the wells herein provided for unless consent to suspend operations temporarily is granted by the lessor; to carry on all operations in accordance with approved methods and practice as provided in the operating regulations, having due regard for the prevention of waste of oil or gas or damage to deposits or formations containing oil, gas, or water or to coal measures or

(Exhibit 11-K—Continued)

other mineral deposits, for conservation of gas energy, for the preservation and conservation of the property for future productive operations, and for the health and safety of workmen and employees; to plug properly and effectively all wells before abandoning the same; to carry out at expense of the lessee all reasonable orders of the lessor relative to the matters in this paragraph, and that on failure of the lessee so to do the lessor shall have the right to enter on the property and to accomplish the purpose of such orders at the lessee's cost: Provided, that the lessee shall not be held responsible for delays or casualties occasioned by causes beyond lessee's control.

(k) Taxes and wages—Freedom of purchase—To pay, when due, all taxes lawfully assessed and levied under the laws of the State or the United States upon improvements, oil, and gas produced from the lands hereunder, or other rights, property, or assets of the lessee; to accord all workmen and employees complete freedom of purchase, and to pay all wages due workmen and employees at least twice each month in the lawful money of the United States.

(l) Nondiscrimination — Not to discriminate against any employee or applicant for employment because of race, creed, color, or national origin, and to require an identical provision to be included in all subcontracts.

(m) Assignment of oil and gas lease or interest

(Exhibit 11-K—Continued)

therein—To file within 90 days from the date of final execution any instrument of transfer made of this lease, or any interest therein, including assignments of record title, working or royalty interests, operating agreements and subleases for approval, such instrument to take effect upon its final approval by the Director, Bureau of Land Management, as of the first day of the lease month following the date of filing in the proper land office.

(n) Pipelines to purchase or convey at reasonable rates and without discrimination—If owner, or operator, or owner of a controlling interest in any pipeline or of any company operating the same which may be operated accessible to the oil or gas derived from lands under this lease, to accept and convey and, if a purchaser of such products, to purchase at reasonable rates and without discrimination the oil or gas of the Government or of any citizen or company not the owner of any pipeline, operating a lease or purchasing or selling oil, gas, natural gasoline, or other products under the provisions of the act.

(o) Reserved deposits—To comply with all statutory requirements and regulations thereunder, if the lands embraced herein have been or shall hereafter be disposed of under the laws reserving to the United States the deposits of oil and gas therein, subject to such conditions as are or may hereafter be provided by the laws reserving such oil or gas.

(Exhibit 11-K—Continued)

(p) Reserved or segregated lands—If any of the land included in this lease is embraced in a reservation or segregated for any particular purpose, to conduct operations thereunder in conformity with such requirements as may be made by the Director, Bureau of Land Management, for the protection and use of the land for the purpose for which it was reserved or segregated, so far as may be consistent with the use of the land for the purpose of this lease, which latter shall be regarded as the dominant use unless otherwise provided herein or separately stipulated.

(q) Overriding royalties—To limit the obligation to pay overriding royalties or payments out of production in excess of 5 per cent to periods during which the average production per well per day is more than 15 barrels on an entire leasehold or any part of the area thereof or any zone segregated for the computation of royalties.

(r) Deliver premises in cases of forfeiture—To deliver up the premises leased, with all permanent improvements thereon, in good order and condition in case of forfeiture of this lease; but this shall not be construed to prevent the removal, alteration, or renewal of equipment and improvements in the ordinary course of operations.

Sec. 3. The lessor expressly reserves:

(a) Rights reserved—Easements and rights-of-way—The right to permit for joint or several use

(Exhibit 11-K—Continued)

easements or rights-of-way, including easements in tunnels upon, through, or in the lands leased, occupied, or used as may be necessary or appropriate to the working of the same or of other lands containing the deposits described in the act, and the treatment and shipment of products thereof by or under authority of the Government, its lessees or permittees, and for other public purposes.

(b) Disposition of surface—The right to lease, sell, or otherwise dispose of the surface of any of the lands embraced within this lease which are owned by the United States under existing law or laws hereafter enacted, insofar as said surface is not necessary for the use of the lessee in the extraction and removal of the oil and gas therein.

(c) Monopoly and fair prices—Full power and authority to promulgate and enforce all orders necessary to insure the sale of the production of the leased lands to the United States and to the public at reasonable prices, to protect the interests of the United States, to prevent monopoly, and to safeguard the public welfare.

(d) Helium—Pursuant to section 1 of the act, and section 1 of the act of March 3, 1927 (44 Stat. 1387), as amended, the ownership and the right to extract helium from all gas produced under this lease, subject to such rules and regulations as shall be prescribed by the Secretary of the Interior. In case the lessor elects to take the helium the lessee

(Exhibit 11-K—Continued)

shall deliver all gas containing same, or portion thereof desired, to the lessor at any point on the leased premises in the manner required by the lessor, for the extraction of the helium in such plant or reduction works for that purpose as the lessor may provide, whereupon the residue shall be returned to the lessee with no substantial delay in the delivery of gas produced from the well to the purchaser thereof. The lessee shall not suffer a diminution of value of the gas from which the helium has been extracted, or loss otherwise, for which he is not reasonably compensated, save for the value of the helium extracted. The lessor further reserves the right to erect, maintain, and operate any and all reduction works and other equipment necessary for the extraction of helium on the premises leased.

(e) Taking of royalties—All rights pursuant to section 36 of the act, to take royalties in amount or in value of production.

(f) Casing—All rights pursuant to section 40 of the act to purchase casing and lease or operate valuable water wells.

(g) Fissionable materials—Pursuant to the provisions of the act of August 1, 1946 (Public Law 585, 79th Congress), all uranium, thorium, or other material which has been or may hereafter be determined to be peculiarly essential to the production of fissionable materials, whether or not of commercial value, together with the right of the United

(Exhibit 11-K—Continued)

States through its authorized agents or representatives at any time to enter upon the land and prospect for, mine and remove the same, making just compensation for any damage or injury occasioned thereby.

Sec. 4. Drilling and producing restrictions—It is covenanted and agreed that the rate of prospecting and developing and the quantity and rate of production from the lands covered by this lease shall be subject to control in the public interest by the Secretary of the Interior, and in the exercise of his judgment the Secretary may take into consideration, among other things, Federal laws, State laws, and regulations issued thereunder, or lawful agreements among operators regulating either drilling or production, or both. After unitization, the Secretary of the Interior, or any person, committee, or State or Federal officer or agency so authorized in the unit plan, may alter or modify from time to time, the rate of prospecting and development and the quantity and rate of production from the lands covered by this lease.

Sec. 5. Surrender and termination of lease—The lessee may surrender this lease or any legal subdivision thereof by filing in the proper land office a written relinquishment, in triplicate, which shall be effective as of the date of filing subject to the continued obligation of the lessee and his surety to make payment of all accrued rentals and royalties

(Exhibit 11-K—Continued)

and to place all wells on the land to be relinquished in condition for suspension or abandonment in accordance with the regulations and the terms of the lease, to be accompanied by a statement that all wages and moneys due and payable to the workmen employed on the land relinquished have been paid.

Sec. 6. Purchase of materials, etc., on termination of lease.—Upon the expiration of this lease, or the earlier termination thereof pursuant to the last preceding section, the lessor or another lessee may, if the lessor shall so elect within 3 months from the termination of the lease, purchase all materials, tools, machinery, appliances, structures, and equipment placed in or upon the land by the lessee, and in use thereon as a necessary or useful part of an operating or producing plant, on the payment to the lessee of such sum as may be fixed as a reasonable price therefor by a board of three appraisers, one of whom shall be chosen by the lessor, one by the lessee, and the other by the two so chosen; pending such election all equipment shall remain in normal position. If the lessor, or another lessee, shall not within 3 months elect to purchase all or any part of such materials, tools, machinery, appliances, structures, and equipment, the lessee shall have the right at any time, within a period of 90 days thereafter to remove from the premises all the material, tools, machinery, appliances, structures, and equipment which the lessor shall not have elected to purchase, save and except casing in wells and other equipment or appara-

(Exhibit 11-K—Continued)

tus necessary for the preservation of the well or wells. Any materials, tools, machinery, appliances, structures, and equipment, including casing in or out of wells on the leased lands, shall become the property of the lessor, on expiration of the period of 90 days above referred to or such extension thereof as may be granted on account of adverse climatic conditions throughout said period.

Sec. 7. Proceedings in case of default.—If the lessee shall not comply with any of the provisions of the act or the regulations thereunder or make default in the performance or observance of any of the terms, covenants, and stipulations hereof and such default shall continue for a period of 30 days after service of written notice thereof by the lessor, the lease may be canceled by the Secretary of the Interior in accordance with section 31 of the act, as amended, and all materials, tools, machinery, appliances, structures, equipment, and wells shall thereupon become the property of the lessor, except that if said lease covers lands known to contain valuable deposits of oil or gas, the lease may be canceled only by judicial proceedings in the manner provided in section 31 of the act; but this provision shall not be construed to prevent the exercise by the lessor of any legal or equitable remedy which the lessor might otherwise have. A waiver of any particular cause of forfeiture shall not prevent the cancellation and forfeiture of this lease for any other cause of for-

(Exhibit 11-K—Continued)

feiture, or for the same cause occurring at any other time.

Sec. 8. Heirs and successors in interest.—It is further covenanted and agreed that each obligation hereunder shall extend to and be binding upon, and every benefit hereof shall inure to, the heirs, executors, adminstrators, successors, or assigns of the respective parties hereto.

Sec. 9. Unlawful interest.—It is also further agreed that no Member of, or Delegate to, Congress, or Resident Commissioner, after his election or appointment, or either before or after he has qualified, and during his continuance in office, and that no officer, agent, or employee of the Department of the Interior, shall be admitted to any share or part in this lease or derive any benefit that may arise therefrom; and the provisions of section 3741 of the Revised Statutes of the United States, and sections 114, 115, and 116 of the Codification of the Penal Laws of the United States approved March 4, 1909 (35 Stat. 1109), relating to contracts, enter into and form a part of this lease so far as the same may be applicable.

In Witness Whereof:

THE UNITED STATES OF AMERICA.

By /s/ A. L. SIMPSON,
Acting Manager—Nevada
Land Survey Office.

(Exhibit 11-K—Continued)

/s/ ROBERT H. MILLER,
Lessee.

/s/ ROBT. M. BAUER,
1385 Westwood Boulevard,
Los Angeles 4, California;

/s/ DORIS M. MILLER,
1385 Westwood Boulevard,
Los Angeles 24, California;
Witnesses to Signature of
Lessee.

Form 4-216 (revised June, 1947)

Stipulation

The lands embraced in this lease (permit), issued under the mineral leasing act of February 25, 1920, (41 Stat. 437), as amended, being within a national forest, the lessee (permittee) hereby agrees:

(1) Not to cut or destroy timber without first obtaining permission from the authorized representative of the Secretary of Agriculture, and to pay for all such timber cut or destroyed at rates prescribed by such representative; to avoid unnecessary damage to improvements, timber, or other cover; unless otherwise authorized by the representative of the Secretary of Agriculture, not to drill any well within 200 feet of any building standing on the leased lands; and whenever required in writing

(Exhibit 11-K—Continued)

by the authorized representative of the Secretary of Agriculture, to fence all sump holes and other excavations made by lessee (permittee).

(2) To do all in his power to prevent and suppress forest, brush or grass fires on the leased land and in its vicinity, and to require his employees, contractors, subcontractors, and employees of contractors or subcontractors to do likewise. Unless prevented by circumstances over which he has no control, the lessee (permittee) shall place his employees, contractors, subcontractors, and employees of contractors and subcontractors employed on the leased land at the disposal of any authorized officer of the Department of Agriculture for the purpose of fighting forest, brush, or grass fires, with the understanding that payment for such services shall be made at rates to be determined by the authorized representative of the Secretary of Agriculture, which rates shall not be less than the current rates of pay prevailing in the vicinity for services of a similar character: Provided, That if the lessee (permittee), his employees, contractors, subcontractors, or employees of contractors or subcontractors, caused or could have prevented the origin or spread of the said fire or fires, no payment shall be made for services so rendered.

During periods of serious fire danger to forest, brush, or grass, as may be specified by the authorized representative of the Secretary of Agriculture, the lessee (permittee) shall prohibit smoking and the building of camp and lunch fires by his employees,

(Exhibit 11-K—Continued)

contractors, subcontractors, and employees of contractors or subcontractors within the leased area except at established camps, and shall enforce this prohibition by all means within his power: Provided, That the authorized representative of the Secretary of Agriculture may designate safe places where, after all inflammable material has been cleared away, camp fires be built for the purpose of heating lunches and where, at the option of the lessee (permittee), smoking may be permitted.

The lessee (permittee) shall not burn rubbish, trash, or other inflammable materials except with the consent of the authorized representative of the Secretary of Agriculture and shall not use explosives in such manner as to scatter inflammable materials on the surface of the land during the forest, brush, or grass fire season, except as authorized to do so or on areas approved by such representative.

The lessee (permittee) shall build or construct, such fire lines or do such clearing on the leased land as the authorized representative of the Secretary of Agriculture decides is necessary for forest, brush, and grass fire prevention and shall maintain such fire tools at his headquarters on the leased land as are deemed necessary by such representative.

(3) To pay the lessor or his tenant, as the case may be, for any and all damage to or destruction of property caused by lessee's (permittee's) operations hereunder; and to save and hold the lessor harmless

(Exhibit 11-K—Continued)

from all damage or claims for damage to persons or property resulting from the lessee's (permittee's) operations under this lease (permit).

(4) To address all matters relating to this stipulation to the Forest Supervisor of the National Forest in which the leased lands are located, or to such other representative as the Secretary of Agriculture may, from time to time, designate in writing delivered to the lessee (permittee).

(5) If lessee (permittee) shall construct any camp on the land, such camp shall be located at a place approved by the forest supervisor, and such forest supervisor shall have authority to require that such camp be kept in a neat and sanitary condition.

(6) That the lessee hereby recognizes existing commitments in the form of Forest Service grazing permits, and agrees to conduct his operations so as to interfere as little as possible with the rights and privileges granted by these permits.

/s/ ROBERT H. MILLER,
Lessee (Permittee).

(Exhibit 11-K—Continued)

Schedule "A"

Rentals and Royalties

Rentals—To pay the lessor in advance on the first day of the month in which the lease issues a rental at the following rates:

(a) If the lands are wholly outside the known geologic structure of a producing oil or gas field:

(1) For the first lease year, a rental of 50 cents per acre.

(2) For the second and third lease years, no rental.

(3) For the fourth and fifth years, 25 cents per acre.

(4) For the sixth and each succeeding year, 50 cents per acre.

(b) On leases wholly or partly within the geologic structure of a producing oil or gas field:

(1) Beginning with the first lease year after 30 days' notice that all or part of the land is included in such a structure and for each year thereafter, prior to a discovery of oil or gas on the lands herein, $1 per acre.

(2) On the lands committed to an approved Co-operative or unit plan which includes a well capable of producing oil or gas and contains a general provision for allocation of production,

(Exhibit 11-K—Continued)

for the lands not within the participating area an annual rental of 50 cents per acre for the first and each succeeding lease year following discovery.

Minimum royalty—To pay the lessor in lieu of rental at the expiration of each lease year after discovery a minimum royalty of $1 per acre or, if there is production, the difference between the actual royalty paid during the year and the prescribed minimum royalty of $1 per acre, provided that on unitized leases, the minimum royalty shall be payable only on the participating acreage.

Royalty on production—To pay the lessor 12½ per cent royalty on the production removed or sold from the leased lands.

The average production per well per day for oil and for gas shall be determined pursuant to 30 CFR, Part 221, "Oil and Gas Operating Regulations."

In determining the amount or value of gas and liquid products produced, the amount or value shall be net after an allowance for the cost of manufacture. The allowance for cost of manufacture may exceed two-thirds of the amount or value of any product only on approval by the Secretary of the Interior.

Filed at hearing December 14, 1953.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 45894

COMMISSIONER OF INTERNAL REVENUE,

Petitioner on Review,

vs.

ROBERT H. MILLER and DORIS K. MILLER,

Respondents on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue petitions the United States Court of Appeals for the Ninth Circuit to review the decision of the Tax Court of the United States entered November 8, 1954, pursuant to its Memorandum Findings of Fact and Opinion filed August 17, 1954, ordering and deciding "That there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $19.26 and $122.64."

This petition for review is taken pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954.

The respondents on review, Robert H. Miller and Doris K. Miller, husband and wife, are residents of Los Angeles, California, and filed joint Federal income tax returns for the calendar years 1948 and

1949, the years involved herein, with the Collector (now District Director) of Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

This case involves income tax deficiencies for the years 1948 and 1949 in the respective amounts of $983.72 and $9,454.06.

Nature of Controversy

The question to be presented to this Court is: Whether the first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capitalized and recovered through depletion deduction under Section 23(m) of the Internal Revenue Code of 1939, or whether such payments are deductible as ordinary and necessary expenses under either subsection (1) or (2) of Section 23(a) of the Code?

In deciding the question adversely to the Government, the Tax Court of the United States followed and cited its prior decision in the case of Olen F. Featherstone, 22 T.C. .... No. 96, filed June 30, 1954, wherein it held that the first year payments made on the non-competitive oil and gas leases issued by the United States pursuant to the authority of the Leasing Act of 1920 (41 Stat. 437) as amended August 8, 1946 (60 Stat. 950, 30 U.S.C.

181 et seq.), are true rentals and are deductible as ordinary and necessary expenses under the provisions of Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

The Commissioner presents that the so-called "rentals" were consideration paid for an oil and gas interest of indefinite duration and, therefore, they should not be deducted in full, but should be capitalized and recovered through depletion allowances.

Statement of Points to Be Relied Upon

The following Statement of Points to be relied upon are set forth as follows:

1. In holding and deciding that first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands are ordinary and necessary expenses and deductible under Section 23(a) of the Internal Revenue Code.

2. In failing to hold and decide that the first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capitalized and recovered through depletion deduction under Section 23(m) of the Internal Revenue Code.

3. In holding and deciding that the payments made by the taxpayers to the first lease years of the non-competitive leases were "true rentals."

4. In failing to hold and decide that the payments made by the taxpayers to the first lease year were in the nature of bonuses or advanced royalty.

5. In failing to hold and find that the payments were made for the acquisition of an economic interest in a mineral deposit within the meaning of Treasury Regulations, and represent a capital investment in the property recoverable only through the depletion allowance.

6. In that the opinion and decision are contrary to the law and the regulations, and are not supported by substantial evidence of record.

7. In ordering and deciding that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $19.26 and $122.64.

8. In failing to order and decide that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $983.72 and $9,454.06.

Wherefore, it is prayed that the matters complained of herein be reviewed and the errors corrected by reversing the decision of the Tax Court herein and remanding the case to the Tax Court to vacate its decision and to enter a decision in accordance with such mandate and opinion.

/s/ H. BRIAN HOLLAND, A.A.R.
Assistant Attorney General.

/s/ R. P. HERTZOG, A.A.R.
Acting Chief Counsel, Internal Revenue Service,
Counsel for Petitioner on Review.

Of Counsel:

C. R. MARSHALL,
Special Attorney, Internal
Revenue Service.

Filed January 28, 1955. T.C.U.S.

[Title of Court of Appeals and Cause.]

PROPOSED STATEMENT OF POINTS

The Commissioner submits the following Statement of Points upon which he intends to rely as the basis of the petition for review:

That The Tax Court of the United States erred:

1. In holding and deciding that first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands are ordinary and necessary expenses and deductible under Section 23(a) of the Internal Revenue Code.

2. In failing to hold and decide that the first year payments made by the taxpayers in 1948 and 1949 in connection with the issuance of non-competitive Government leases on oil and gas lands should be capitalized and recovered through depletion deduction under Section 23(m) of the Internal Revenue Code.

3. In holding and deciding that the payments made by the taxpayers to the first lease years of the non-competitive leases were "true rentals."

4. In failing to hold and decide that the payments by the taxpayers to the first lease year were in the nature of bonuses or advanced royalty.

5. In failing to hold and find that the payments were made for the acquisition of an economic interest in a mineral deposit within the meaning of Treasury Regulations, and represent a capital investment in the property recoverable only through the depletion allowance.

6. In that the opinion and decision are contrary to the law and the regulations, and are not supported by substantial evidence of record.

7. In ordering and deciding that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $19.26 and $122.64.

8. In failing to order and decide that there are deficiencies in income tax for the years 1948 and 1949 in the respective amounts of $983.72 and $9,454.06.

/s/ H. BRIAN HOLLAND, A.A.R.
Assistant Attorney General.

/s/ R. P. HERTZOG, A.A.R.
Acting Chief Counsel; Internal Revenue Service,
Counsel for Petitioner on Review.

Affidavit of mailing attached.

Filed April 12, 1955. T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of The United States, do hereby certify that the foregoing documents, 1 to 15, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation for Contents of Record on Review" in the proceeding before The Tax Court of The United States entitled: "Robert H. Miller and Doris K. Miller, Petitioners, vs. Commissioner of Internal Revenue, Respondent, Docket No. 45894" and in which the respondent in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of April, 1955.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States.

[Endorsed]: No. 14,735. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Robert H. Miller and Doris K. Miller, Respondents. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed April 22, 1955.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.